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MEMORANDUM FOR: THE RECORD

SUBJECT : Japan's Economic Ties with  
the USSR and China.

The attached memorandum was prepared at the request  
of [REDACTED]

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We compared Japan's past and present relations with the two Communist powers and speculated on the consequences for Japanese freedom of action in the event of a collapse in US-Soviet detente or a resumption of cooperation between Moscow and Peking. Despite the seemingly large potential for increased economic ties, we concluded that little expansion would occur during the next decade. Japan's economic, defense, and ideological ties with the West are too strong, and there are too many barriers -- political and economic -- to substantial increases in trade and investment with the USSR and China.

As requested, the paper was forwarded  
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## JAPAN'S ECONOMIC TIES WITH THE USSR AND CHINA

### Past Relationships

1. Despite rapid growth in trade during the past decade and much high-level discussion in the last two years, Japan's economic ties with the USSR and China are still quite limited. In fact, Japanese-Chinese ties were much broader early this century when each country accounted for about one-fourth of the other's global trade. At that time, Japan looked to China as a supplier of raw materials while China's coastal trade centers were a major market for Japanese goods. After a 20-year hiatus following World War II, Japan once again became China's leading trading partner, but China accounts for only 3% of Japan's trade.

2. Relations with the Soviet Union, on the other hand, were fraught with conflict until the early 1960's. Historically, both Tokyo and Moscow have coveted the territory and resources of Siberia and Sakhalin Island. Their dispute over ownership of some of the Kuril Islands still is a live political issue in both countries. Even though trade between the two has grown rapidly since the signing of the first post-World War II trade agreement in 1957, it accounts for only 2% of Japan's global trade and 3% of the USSR's. In 1972, Japan lost out to West Germany as the Soviets' leading non-Communist trading partner and last year dropped to third place after the United States.

3. Especially since US reapprochement with the Soviet Union and China, the Japanese have been eager to expand economic ties with both countries. Political issues, however, remain a stumbling block. Because Moscow and Peking frequently use Tokyo as a foil against each other, the Japanese find themselves walking a tightrope in order to maintain good relations with both. In addition, bilateral issues between Japan and each of the Communist powers have stalled progress on the economic front. As with the Soviet Siberian resources projects, however, mutual economic benefits sometimes have been great enough to overcome seemingly firm political preconditions on both sides.

Nature of Future Ties.

4. On the surface, there appear to be opportunities for vastly expanded economic ties between Japan and China or the Soviet Union or both. By and large, their economies tend to be complementary, not competitive. Differences in the level of development are not necessarily a constraint.

5. In most respects, Japan has a considerable edge over the other two in what it can bring to an economic relationship. With a highly developed economy that normally grows at a rate twice the world average, Japan is a huge supplier of all kinds of manufactured goods and an equally huge market for both primary and manufactured products. Beyond this the Japanese can offer:

- financial resources to support development projects,
- technical skills in a wide range of industries, and
- a massive international marketing system to handle trade in all kinds of goods.

6. In theory at least, China also has much to contribute:

- a relatively large agricultural and industrial raw material base,
- a potentially large market for both producer and consumer goods,
- potentially large investment opportunities, and
- a massive low-wage labor force.

7. The Soviets have an equally large potential for adding to an economic partnership. Their economy has many of the same attributes of China's and, in addition, offers:

- an increasingly consumption-oriented population and
- proven rich resources in Siberia.

8. It remains far from certain whether the potential for substantially greater economic interaction between Japan and either China or the Soviet Union can be realized over the next several years. On balance, we think the outlook is for only limited expansion. With China, for example, trade will continue to be the only major bond. The chief deterrent to other ties and even to greater trade is Peking's concern about economic

self-sufficiency. The Chinese will not permit more than minimal foreign participation in development projects nor will they allow themselves to become heavily dependent on a single trading partner.

9. Even if China opened up completely, chances are slim that the nature of its economic relations with Japan would change significantly. China's only key surplus raw material will be oil, and the most optimistic estimate of supplies going to Japan by 1980 would bring China only \$3 billion - \$4 billion in foreign exchange. Opportunities for increased food shipments to Japan do not appear particularly bright since China has trouble feeding its own people. The extent of Japanese inroads into the Chinese market will be limited by China's continued foreign exchange constraint and its low level of development. As for investment, the best opportunities are in manufacturing, but they would not involve large sums.

10. The Soviet Union is more open to foreign economic interests than China, but it is difficult to conceive of the Japanese looking much beyond their current focus on industrial raw material development. In this field Japan already has spent several hundred million dollars and is prepared to spend several billion more to secure needed supplies. The Japanese, however, are not apt to look upon the USSR as a dependable source of

agriculture. As a market, the Soviet Union has never been very attractive to the Japanese, and they already face increasing competition from other suppliers. A major portion of Japan's sales to the USSR will stem from their joint resources projects. More fundamentally, the long-term mutual distrust between the two countries will remain a deterrent to greater economic ties.

#### Economic Competition

11. Neither the Soviet Union nor China poses a real threat over the next decade to Japanese economic hegemony in Southeast Asia. Indeed, the key to the rapid growth of the countries in the region has been their ability to sell raw materials to Japan. During the past decade or so Japan has accounted for nearly half of their export growth. As Japan continues to move out of consumer goods industries, it will become an important market for light manufactured goods as well.

12. The Chinese want influence in Southeast Asia, but mainly political, not economic. They have little to offer other than labor-intensive, low-technology goods which the countries in the region produce themselves. The real threat to the Japanese is that they themselves are not well liked because of their business methods. The Russians, for their part, are even less attractive to countries in this region. Moreover, Soviet interests lie elsewhere -- with the developed nations that can provide them with advanced technology. We see no area where the Soviets offer any kind of economic threat to the Japanese.

Where Tokyo Stands

13. Japan's prime interest in both countries lies in securing industrial raw materials. Until recently, the Soviet Union had a clear edge over the Chinese, who had relatively little to offer Japan. Just this summer, for example, Tokyo and Moscow reached agreement on large-scale timber and coking coal deals. With the promise of enormously increased oil production, however, the Chinese now have bargaining power. As a result, competition already is under way to exploit Japan's energy resources vulnerability for political purposes.

14. The Japanese, however, are not willing to pay too high a price for these resources.

- \* They will not abandon their neutrality in the Sino-Soviet dispute. The Tyumen oil deal is now dead in part for this very reason.

- \* Nor will the Japanese allow themselves to become excessively dependent on either China or the USSR.

Thus, Tokyo gains no real leverage from being alternately wooed by Moscow and Peking. Because the Japanese feel caught in the middle, they will continue to be on the defensive in their dealings with the two Communist countries.

15. If the Japanese succeed in gaining access to both Soviet and Chinese energy supplies on reasonable terms, it will



be thanks largely to the United States. If detente continues and US technology and financing (private and/or government) are available for the Yakutsk gas and Sakhalin gas and oil projects, then all parties will be more or less content. Without some sort of US participation, however, neither project will get off the ground because the Japanese lack the know-how and will not take the risk of going it alone.

16. A major breakdown in detente would push Tokyo toward a closer relationship with China, where US involvement would not be an issue. The Japanese already feel less threatened militarily by Peking and believe the Chinese are far more trustworthy than the Soviets.

17. An end to the Sino-Soviet dispute would be of dubious value to Japan. China would still want to sell its oil and the USSR would still need financial and technical help in developing its energy potential. Without the incentive to stymie each other, however, neither Moscow nor Peking would be as disposed to compromise with Japan on bilateral issues, such as the northern territories and Taiwan, that cause friction between them. Moreover, if detente were to collapse, the specter of a more or less united communist bloc on their flank might so intimidate the Japanese that they would turn much more to the United States. A healthy US-Japanese partnership would be a much better counterweight in maintaining the balance of power in the Pacific.

18. From Japan's standpoint, the key to greater economic ties with both the Soviet Union and China is continued good relations between them and the United States. Even if there were a resumption of cooperation between Moscow and Peking, Tokyo could at least maintain the limited freedom of action it has now. From a US standpoint, better Sino-Soviet-Japanese relations would appear to be a net gain. Japanese access to the raw materials of China and the Soviet Union should lessen the chances for potentially ruinous US-Japanese competition elsewhere.

Relationships in Perspective

19. Despite the likelihood of some expansion of Tokyo's relations with the USSR and China, Japan's major economic ties will remain with the United States and Western Europe.

- No opportunities for Japanese equity investment exist in either the Soviet Union or China.
- Neither country will be able to supply a significant portion of the foodstuffs Japan must import.
- They are not large markets for Japanese goods nor will they be for many years.
- Tokyo's desire to diversify sources of raw material supply will preclude too great a dependence on either Peking or Moscow.

20. Even more basic are the ideological and defense considerations that bind Japan to the West. Age-old Japanese distrust of the Soviets may diminish, but it will not disappear. Despite their historical affinity for the Chinese, the Japanese will be mindful of putting too many eggs in Peking's basket. Japan's future security and welfare are too much bound up in their ties with the United States for Tokyo to depart radically from its current cautious stance vis a vis the USSR and China.

21. Tokyo's long-range planning confirms our judgment that the two communist powers will remain at the periphery of Japan's national interests. Practically all projections show little, if any, increase in trade shares held by the USSR and China. Indeed, we think the shares will shrink. The Japanese are projecting overseas investment of about \$30 billion during the next decade, but show very little going to China or the Soviet Union. In our opinion, only the most dramatic and unforeseen events will change that outlook.